Omnicell Fourth Quarter and Full Year 2022 Financial Results
February 28, 2023 – 1:30pm PT/4:30pm ET

Kathleen Nemeth:

Good afternoon. Welcome to the Omnicell fourth quarter and full year 2022 financial results conference call. On the call with me today are Randall Lipps, Omnicell Chairman, President, CEO and Founder; Scott Seidelmann, Executive Vice President and Chief Commercial Officer; and Peter Kuipers, Executive Vice President and Chief Financial Officer.

This call will contain forward-looking statements including statements related to financial projections or other statements regarding Omnicell's plans, objectives, expectations, cost saving actions or outlook that are subject to risks, uncertainties and other factors that could cause actual results to differ materially from those expressed or implied. For a more detailed description of the risks that impact these forward-looking statements, please refer to the information in our press release issued today in the Omnicell annual report on Form 10-K filed with the SEC on February 25, 2022, and in other more recent reports filed with the SEC. Please be aware that you should not place undue reliance on any forward-looking statements made today. All forward-looking statements speak only as of the date hereof or the date specified on the call. Except as required by law, we do not assume any obligation to update or otherwise release publicly any revisions to our forward-looking statements. Our results were released this afternoon and are posted in the Investor Relations section of our website at ir.omnicel.com.

Additionally, we would like to remind you that during this call, we will discuss some non-GAAP financial measures. Reconciliation of these non-GAAP measures to the most comparable GAAP financial measures are included in our financial results press release issued today. With respect to forward-looking non-GAAP measures, we do not provide a reconciliation of forward non-GAAP measures to the comparable GAAP measures on a forward-looking basis as these items are inherently uncertain and difficult to estimate and cannot be predicted without unreasonable effort.

With that, I will turn the call over to Randall.

Randall Lipps:

Good afternoon. Thank you for joining us today.

I would like to begin by providing some context on what we are currently seeing as it relates to the overall health care environment and the medication management markets that we address. We'll also discuss the Form 8-K we filed today detailing additional cost savings actions we are taking in an effort to ensure we are well positioned to navigate the ongoing economic challenges we face. I then will walk through some highlights for the fourth quarter and full year 2022 as well as our priorities for 2023.

Starting with the current health care environment.

Capital committees within our health system partners continue to look to be highly focused on ensuring optimal ROI for their budgetary spend and investments. We believe we are in a strong position to help our

health system and retail customers realize savings and ROI as they invest in Omnicell's connected devices and SaaS and tech-enabled services.

Although it appears most customers are still in a capital-constrained environment, we believe we are uniquely positioned to help health systems address many of the medication management pain points they are facing today.

While we are pleased to see greater stability within our customer base, we remain mindful of the potential ongoing headwinds given the continued macroeconomic uncertainty for us and our customers. As a result, we intend to take what we believe is a cautious stance on how we manage the business.

In November 2022, we disclosed that we were reducing our workforce by approximately 9% across a majority of our functions. We are continuing to refine our cost structure and are maintaining a focus on expense management to align with our anticipated revenues.

Now in view of that, today, we announced we will be further reducing our workforce across many of our functions. In addition, we are reducing our real estate footprint to align with our broader high-load work strategy and to further reduce costs. To that end, we expect to reduce square footage by the end of the second quarter of 2023.

Through these initiatives, including the reduction in workforce, we announced in November 2022, along with other expense containment efforts, we anticipate the annualized savings from operating expenses to be around $50 million for 2023, which does not include the expected volume-based reductions within cost of sales. While it is always difficult to make decisions that adversely impact our employees, we are not immune to the challenges companies across many industries continue to face and we are committed to taking actions we believe will help us to be well positioned for the long term.

Now turning to some of the highlights of the fourth quarter and full year 2022. Now as I meet with our customers, certain things are becoming increasingly clear to me. First, Omnicell's Advanced Services provide measurable ROI. We believe this is important to our healthcare partners, particularly in the current economic environment.

In addition, our connected devices and Advanced Services improve compliance, and we believe also improve nurses and pharmacists' day-to-day work experience. This, in turn, appears to be improving patient care. We believe this combination of factors validates our strategy and the industry vision of the autonomous pharmacy. The market demand for our service is clear to us. We are energized by our mission and believe we are uniquely positioned to help our health systems and retail partners to transition to a next-generation cloud-native capabilities that we anticipate we will ultimately transform the pharmacy care delivery model.

Second, despite what continues to be a challenging macroeconomic environment, customers are continuing to convert from competitors to Omnicell. We announced 2 new long-term sole-source agreements during the second half of 2022, and we added a new competitive conversion during the fourth quarter of 2022.

This brings us to sole-source contracts with more than half of the top 300 U.S. health systems. We believe these new wins exemplify the customer momentum in our Advanced Services that continued throughout the end of the year. Scott will speak to our customer wins in more detail momentarily.

While we are seeing stabilization among our customers' capital spend with respect to connected devices, we remain confident in our expected growth trajectory of Advanced Services, particularly our robotic based services such as IBCS and CPDS.

This positive momentum reaffirms our belief and our long-term vision to transform Omnicell to an as-a-service company. While 2022 presented unprecedented challenges within the industry, we are focused on the long term and believe we are well positioned to deliver increasing value for all our stakeholders.

Now turning to our high-level financial results. 2022 bookings were $1.54 billion compared to $1.217 billion for full year 2021. The reflecting a slowdown primarily in our point-of-care bookings, particularly offset by an increase of an Advanced Services bookings.

Our full year 2022 GAAP revenues were $1.296 billion, and non-GAAP revenues were $1.297 billion, an increase of 14% from the prior year. Full year 2022 GAAP earnings per share were $0.12 per share and non-GAAP earnings per share were $3 per share. We intend to manage the company to deliver growth in GAAP earnings over the long term. We expect this will require a more targeted approach to our stock-based compensation programs and overall cost efficiency.

Now looking ahead to 2023. As I noted earlier, we intend to take what we believe is a cautious approach to managing the business given the current macroeconomic environment. Our priorities for 2023 are the following: one, deploying what we think is a prudent plan to pursue our growth agenda while also working to lower cost and improve efficiencies throughout the company; two, continuing to make meaningful progress on the integration of recent acquisitions to drive expected synergies and three, invest in R&D and innovation that is expected to drive future growth.

To reiterate, while we face challenges in 2022, like conviction and Omnicell's future has never been stronger. I look forward to working alongside the Omnicell team as we endeavor to deliver long-term value for all of our stakeholders.

Before I turn the call over to Scott, I would like to note that we announced today that Peter Kuipers will be stepping down from his role as CFO and will be leaving the company on July 1, 2023. I've worked closely with Peter over the last 7 years and appreciate the significant contributions Peter has made to Omnicell over that time. Peter joined the company when our revenues were just under $500 million annually, and we just concluded 2022 with nearly $1.3 billion in revenue. Now we have launched the search for our next CFO, and Peter will help to ensure a smooth transition. Thank you, Peter.

With that, I will turn the call over to Scott.

Scott Seidelmann:

Thank you, Randall.

As Randall noted, we are encouraged that demand conditions within health systems and hospitals appear to be stabilizing. Our customers continue to face labor constraints and, in many cases, remain under capital budget freezes. And while we have seen this environment primarily impact our point-of-care business, we are continuing to see strong demand for our Advanced Services.

Advanced Services are a key part of our intelligent medication management infrastructure, which is intended to help customers address problems in their medication management processes from the inpatient bed to the home. Let's walk through a few of our recent wins that we believe highlight the power of our offering.

First is an Ohio-based health system that has chosen to partner with us for central pharmacy dispensing service, IV compounding service and our inventory optimization service. Additionally, this health system will convert to our XT automated dispensing system. We believe that the comprehensive nature of our solution was critical to winning this competitive conversion.

Also in Q4, one of the largest integrated health care networks in Tennessee and an existing customer, upgraded its ADCs to our XT dispensing system and also contracted for central pharmacy dispensing service, IV compounding service and our inventory optimization service. Again, the health system has indicated that they partnered with us because of the potential total value creation of our solution across their medication management care delivery model.

Also, as part of our Advanced Services portfolio, our recently acquired specialty pharmacy service continues to gain traction with health systems that are looking for a partner that can help to quickly stand up or optimize their specialty pharmacy operations. For example, in Q4, the largest private teaching hospital in Florida chose to partner with Omnicell to establish a new specialty pharmacy program. Citing our specialty pharmacy expertise and managed services model as key reasons for the partnership.

Overall, we are very pleased with the demand that we are seeing for Advanced Services. And as such, in 2023, we will continue R&D investment across the portfolio. Additionally, for EnlivenHealth, in 2023, we will focus on integrating the technology platforms of the 2 companies that we acquired in late 2021. We believe that the strong demand we have seen for our Advanced Services, coupled with our continued R&D investment should position us well for growth in the future.

With that, I will turn the call over to Peter.

Peter Kuipers:

Thank you, Scott.

Good afternoon. 2022 was a challenging year for the company. We found that many health systems and hospitals reacted to the ongoing macroeconomic challenges by implementing capital budget freezes and additional cap approval requirements, resulting in elongated sales cycles. This mostly impacted our point-of-care business have resulted in the company lowering its full year 2022 guidance.

I'm pleased to note that we have not seen further deterioration in the health care environment in the last quarter of 2022 and so far in 2023. For fourth quarter 2022, we delivered results that generally exceeded our revised 2022 guidance ranges. Our health care system and retail pharmacy customers look to continue to rely on and partner with Omnicell to help them deliver improvements in patient care, to achieve return on investments and build long-term strategic relationships in an effort to realize the industry vision of the autonomous pharmacy.

Our fourth quarter 2022 GAAP and non-GAAP revenues were $298 million, or $3 million above the top end of our revised 2022 guidance range. A full reconciliation of our GAAP to non-GAAP results is included in

our fourth quarter and full year 2022 earnings press release and is posted on our Investor Relations website. fourth quarter 2022 earnings per share in accordance with GAAP were a loss of $0.64 per share compared to income of $0.37 per share in the previous quarter and income of $0.28 per share in the fourth quarter of 2021.

The fourth quarter 2022 earnings per share in accordance with GAAP includes the impact of $70 million for severance-related expenses as disclosed in the Form 8-K we filed on November 30, 2022, as well as the impact of $4 million for the impairment of operating lease right-of-use assets as we rationalized our office space as part of the efforts to align with our broader hybrid work strategy.

Non-GAAP gross margin for the fourth quarter of 2022 was 45.3%, a decrease of 220 basis points from the previous quarter primarily due to lower revenue volume leverage. Cost actions, including the previously announced headcount reductions in November 2022 generally had very little impact on the fourth quarter 2022 results.

We expect to begin to see the benefit from these actions on gross margin and operating expenses more fully in the second quarter of 2023. We expect to see volume leverage beginning to return by the fourth quarter of 2023 as the revenue is projected to grow throughout the year.

Fourth quarter non-GAAP EBITDA was $26 million compared to $61 million in the previous quarter and $52 million in the same period last year. Fourth quarter 2022 non-GAAP earnings per share were $0.33 per share compared to $1 per share in the previous quarter and $0.92 per share in the same period last year. Fourth quarter non-GAAP earnings per share were above our 54th quarter 2022 guidance due to higher revenue, lower cost of sales, solid expense management and lower performance-based compensation.

Turning now to review our full year 2022 results. Bookings for full year 2022 were $1.054 billion compared to $1.217 billion for the full year 2021. Bookings decreased 13% over the prior year, primarily due to a slowdown in point-of-care bookings as an increasing number of health systems, implemented CapEx, budget freezes or additional CapEx approval requirements, partially offset by an increase in asset services bookings.

Our total backlog was $1.215 billion as of December 31, 2022 compared to $1.254 billion as of December 31, 2021. As further detail on Slide 13 of our earnings presentation, in the Form 8-K we filed today and all based on our Investor Relations website prior to today's call.

We are now providing additional information about the portion of our backlog derived from both products and Advanced Services bookings. Backlog represents the dollar amount of bookings for our products and Advanced Services, which has not yet been recognized as revenue. We consider backlog that is expected to be converted to revenues in more than 12 months to be long-term backlog.

Product backlog includes connected devices, such as our XT Series automated dispensing systems and the product portion of our central pharmacy, dispense service and IT compounding service. Product backlog as of December 31, 2022, was $797 million, of which $53 million is short-term product backlog and $294 million is long-term product backlog. We believe the majority of the long-term product backlog will be convertible into revenues between 12 and 24 months.

Advanced Services backlog only includes the portion of our Advanced Services multiyear contracts, which have a stated minimum commitment within the agreement. Advanced Services include services such as our EnlivenHealth Solutions, 340B solutions, specialty pharmacy services, inventory optimization service and other software solutions as well as the service portion of our central pharmacy dispense service and IC compounding service.

While we partner closely with our customers when providing Advanced Services and the majority of our Advanced Services are provided on the multiyear contracts. Only a portion of these contracts has stated minimum commitments. Advanced Services backlog, consisting of minimum contractual commitments as of December 31, 2022, was $418 million, of which $50 million is short-term Advanced Services backlog and $369 million is long term Advanced Services backlog.

Long-term Advanced Services backlog typically represents multiyear subscription agreements usually the contractual terms of between 2 and 7 years. Some of which have not yet been implemented, which will be converted to revenue ratably over the contractual term.

Despite the challenging macroeconomic environment, our full year 2022 GAAP revenues were a record $1.296 billion, and non-GAAP revenues were a record $1.297 billion. Our 2022 non-GAAP revenue saw an increase of $164 million or 14% from 2021. The strong year-over-year non-GAAP revenue increase reflects continued demand for Omnicell medication management and adherence automation solutions as well as the contribution of revenue from scaling Advanced Services and the impact of recent acquisitions.

Our full year 2022 earnings per share in accordance with GAAP were $0.12 per share. Our full year 2022 non-GAAP earnings per share were $3 per share, a decrease of $0.81 per share or 21% from 2021. The year-over-year decrease was mostly driven by reduced operating leverage from lower than originally expected revenue during the second half of 2022.

For full year 2022, total inflationary costs were $26 million which is $4 million lower than expected at the time of the third quarter 2022 earnings call, primarily due to moderation in semiconductor steel and freight cost inflation. For full year 2022, we delivered non-GAAP EBITDA of $193 million, which is above our 2022 revised guidance range. Full year 2020 non-GAAP EBITDA margin of 15% was a decrease of 540 basis points from the previous year.

Now moving to cash flow. Full year 2022 free cash flow of $17 million, a decrease of $156 million is primarily due to lower GAAP net income as well as the impact of higher inventory and timing of cash collections.

At the end of the fourth quarter of 2022, our cash balance was $330 million, up from $266 million as of September 30, 2022. The $64 million increase in cash is the result of strong free cash flow and record cash collections in the fourth quarter of 2022. Free cash flow during the fourth quarter of 2022 was $65 million compared to $5 million from the previous quarter and $43 million in the fourth quarter of 2021.

In terms of accounts receivables, days sales outstanding for the fourth quarter of 2022 was 93 days, unchanged from the previous quarter. Inventories as of December 31, 2022, and were $148 million, an increase of $1 million from the prior quarter and an increase of $28 million from the fourth quarter of 2021. It is important to note that the inventories as of December 31, 2022, includes approximately $8 million of expense purchases and receipts of semiconductors that we believe will help reasonably secure supply for future customer implementation time lines. While supply and demand for semiconductors are becoming more balanced, lead times continue to be long.

The teams continue to execute well as we adjust to revise revenue volumes, particularly in point of care. We continue to expect with a high level of confidence that our supply chain has and will continue to procure critical components for our products including semiconductors to deliver on mission-critical systems and connected devices to our health care customers.

Now moving on to 2023 full year and first quarter 2023 guidance. Given the continued marketing on the concern team, we expect 2023 bookings to be between $1 billion and $1.1 billion. Bookings includes both the bookings from products as well as the bookings from our Advanced Services. The midpoint of the 2022 bookings guidance is approximately equal to our full year 2022 bookings.

For full year 2023, we expect total revenues to be between $1.150 billion and $1.190 billion. We expect product revenue to range between $740 million and $760 million, consisting of expected revenue from short-term product backlog to a lesser extent, revenue from within year bookings and for recurring consumables revenue.

We expect 2023 service revenues to be between $410 million and $430 million. Our service revenue includes both revenue from Advanced Services as well as revenue from technical services. We expect service revenue from Advanced Services revenue to be between $200 million and $210 million, which is a 10% increase at the midpoint compared to 2022, and represents approximately 18% of 2023 revenues.

The 2023 Advanced Services revenue consists of recurring revenue of the installed base of and services solutions and the expected revenue from the short-term and Advanced Services backlog and to a lesser extent, expected new Advanced Services implementations.

We expect service revenue for technical services, which includes our post-installation technical support, training and customer education solutions to range between $210 million and $220 million in 2023. And an increase of 4% as compared to 2022.

Please see Slide #14 in our earnings presentation published on our Investor Relations website for a summary of the revenue guidance components. Today, we also announced a reduction in force as part of our cost containment measures, together with the cost containment actions we announced in November 2022 in an effort to create operating leverage and align our cost with expected revenue volume.

Of the total reduction in force announced in November as well as today's announcement, approximately half of the headcount reduction was within functions included in cost of sales, mostly from reduced volume. Of the portion of reduction in force that will reduce operating expenses going forward, nearly all of us went functions included in SG&A with very little in R&D as we continue to make key investments that are expected to drive innovation.

We expect gross margin percentage to modestly expand in the second half of 2023 due to the expected benefits from these cost containment actions as well as expected volume leverage, increased impact of pricing actions and moderating inflationary costs. We continue to seek to balance cost containment with investing and innovation, specifically including Advanced Services and strategic next-generation automation solutions.

A majority of the approximately $50 million of anticipated annual operating expense savings expected to be derived from the recent reductions in force and other expense containment efforts is from functions

included in SG&A. The expected 2023 operating expense annual savings will be largely offset by the impact of year-over-year inflation in employee salaries and increases in expected performance-based compensation find the cost increases and investments in R&D.

We expect non-GAAP operating expenses in total to be flat year-over-year with non-GAAP SG&A, down slightly by offset slightly by an increase in non-GAAP R&D, which reflects our focus on cost savings while continuing investments in our growth agenda.

We expect total year 2023 non-GAAP EBITDA to be between $120 million and $135 million. The total year 2023 non-GAAP EBITDA guidance includes the impact from estimated lower revenue volume, cost actions designed to create operating leverage, expect to reduce inflationary pressures and anticipated favorable impact from the pricing actions we put in place in recent years and which we expect to have a greater impact in 2023.

We expect EBITDA margins to expand as we move through 2023 based on the projected timing of cost actions, pricing actions and the impact of volume leverage within gross margin and operating expenses in the second half of the year. We expect 2023 non-GAAP earnings to be between $1.55 and $1.80 per share. This takes into account a lower expected blended tax rate in 2023 and the expected increase in share count as a result of new shares being issued under our employee stock plans.

For full year 2023, we are assuming an effective blended tax rate of approximately 5% in our non-GAAP earnings per share guidance compared to an actual blended tax rate of 6% in 2022.

For the first quarter of 2023, we are providing the following guidance: we expect total first quarter 2023 revenues to be between $273 million and $283 million, with product revenues to be between $179 million and $184 million, and service revenues to be between $94 million and $99 million; we expect first quarter 2023 non-GAAP EBITDA to be between $6 million and $12 million; and we expect first quarter 2023 non-GAAP earnings per share to be between $0.04 per share and $0.14 per share.

We are seeing strength in our customer partnerships, which include long-term sole source agreements with over 150 of the top 300 U.S. health systems of our customers in the top 300 U.S. health systems, more than half have contracted for at least 1 of our Advanced Services. As Advanced Services are scaling, we see strong momentum in the pipeline to continue to expand the adoption of our Advanced Services within the top 300 U.S. health systems.

We continue to strive to deliver value for all of our stakeholders in this challenging macroeconomic environment. And we remain confident in our potential long-term opportunities. If you look forward, to updating you on our progress in the coming quarters.

Lastly, I want to thank Randall for your kind words earlier in the call. It has been a great privilege to have worked with you, our executive leadership team, our Board of Directors and all of the incredible people who make Omnicell a great company.

I'm grateful to have led the finance global supply chain, international IT in corporate development teams and have played a part during the time of scaling and business model transformation. I'm proud of being a part of the team that has created such value within health care.

At this point, I have accomplished the objectives I've set out to achieve when I joined Omnicell over 7 years ago, and we're looking forward to the next chapter in my career. I will be supporting the team as the search for my successor commences and I will help to assist in a smooth transition later this year. I know that the company is very well positioned to continue to evolve and take full advantage of the need for medication management automation solutions and I will always wish Omnicell great success.

With that, we would like to open the call for your questions.

Operator: (Operator Instructions) Our first question comes from Stan Berenshteyn from Wells Fargo Securities.

Stan Berenshteyn: I guess, first, Peter, it's been a pleasure working with you. I wish you the best of luck. Maybe first, I want to also say thank you for breaking down the backlog details. That's very helpful. Maybe first, I just wanted to get a clarifying question. The announced savings that you announced today, is that also factored into guidance that you provided for the full year?

Peter Kuipers: Yes. Thank you, Stan. This is Peter. I really like working with you as well. Yes, to your last question, the impact of the cost access today across containment actions are included and factored into the guidance that we provided both for total year '23 and also for the first quarter of '23.

Stan Berenshteyn: Got it. Okay. That's helpful. And then on Advanced Services, so comments on Advanced Services from, I believe, last quarter seems to suggest that pacing expectations were pretty much unchanged from the Investor Day. But it seems like the guidance we provided right now, the expectations are somewhat moderated. Is there anything to specifically call out of what changed from maybe a quarter or 2 ago?

Scott Seidelmann: Stan, it's Scott. No, not really. I think that we continue to see strong demand. We continue to be excited. I think that generally, the Advanced Services deliver a positive ROI for the customers. And that's why we continue to see demand in this macroeconomic environment. I think as it relates to the guidance in 2023, I think that obviously, we're taking a cautious approach to this, and we'll go from there.

Peter Kuipers: Yes, maybe to add to that. So really, the guide for bookings for '23, if you play down on that, we're all not breaking out limited bookings between core product bookings and trade services bookings within that core bookings are expected to be down through the year and advanced service bookings are expected to be increasing very well, if you will, from nation perspective.

Stan Berenshteyn: Got it. And then maybe one quick one here on the point-of-sale XT products. So it seems like you've been upgrading them recently based on them reaching end of life. You should obviously have good visibility there as you think beyond 2023. So I'm just curious, if you think into 2024 or maybe even 2025, what's the replacement pipeline looking like in 2024 and 2025? Is it steady versus 2023 higher or lower? Any guidance you can give us here?

Peter Kuipers: We do have a solid pipeline of replacements over the next handful of years. I think we do look at that as -- we do have predictability to it. It is steady. It's only a component of ADC sales in any given quarter. So it does give us nice predictability.

Operator: Our next question comes from the line of Matt Hewitt from Craig-Hallum Capital Group.

Matt Hewitt: And I'll echo the other comments on Peter. Congratulations and best of wishes in your future endeavors. Maybe the first one for me, and you talked about this a little bit, but I'm wondering if you could give a little more color on the hospital budgets and capital freezes. It sounds like things were relatively stable, Q4 so far into Q1. But what are you hearing from customers? How are they prioritizing? Obviously, they still need equipment, they still need to upgrade some pieces, even yours. I'm just curious what you're hearing from them and what are their expectations as the year progresses?

Randall Lipps: Yes. This is Randy. I think we've definitely seen a stabilization in the market. And -- but people are still being pretty cautious on committing capital to more systems until they really have to. And when systems do come out of date or they do an expansion that (inaudible) they go ahead and put those through.

So I think it gives us comfort in that, and we don't see any decrease in the market. We haven't seen any significant uptake yet, but I think it gives us a good starting point for the year. And I think we're still going to be cautious about the macroeconomic environment because I think it's still assembling not having a few more quarters of positive results for these health systems.

Matt Hewitt: Fair enough. And then maybe a question on the specialty pharmacy business. Congratulations on the win there. As you look out over the course of this year, it sounds like you're having good discussions. Should we be looking at that as a nice growth driver for you this year and maybe kind of setting the stage for '24 and beyond but clearly a nice driver this year.

Scott Seidelmann: This is Scott. Absolutely, specialty pharmacy and the sort of creation or growth of in-house specialty pharmacies for health systems certainly a tailwind. The market is trending very positively there. And then we are very bullish and excited about the growth of our offering there.

Operator: Our next question comes from the line of Scott Schoenhaus from KeyBanc.

Scott Schoenhaus: Peter, it's a pleasure knowing and working with you over these past several years as well. I guess my first question is on the margins. Your first quarter implied margins are 3%. We haven't really seen that since 2017, and it implies a steep acceleration throughout the rest of the year. Can you kind of walk us through what's embedded in guidance? Is it a sequential stair stuff that's spread evenly over each quarter? Or is there some seasonality with these cost cuts and orders coming in? Can you just help us walk through the steep acceleration from 3% to high double digits to get to your 10% margins for the year, please?

Peter Kuipers: Yes. Thank you, Scott. Great working with you as well.

Yes. I think you mentioned most of the drivers there, right? So really going through the year, the cost taxes that we announced both in November and this year, both the cost of goods sold and in operating expenses will have a more full impact to debate P&L really starting middle of the year. So we see the ramp up there, if you will, from a profitability perspective.

Also in the second half of the year, we see more volume leverage, specifically as advanced services. scale more and then also we see some improvement in volume leverage in important care as well. And then lastly, we see pricing access that we announced previously, coming through more heavily and impacting every single quarter as we go through the year.

Plus then lastly, the inflationary costs for semis, steel and freight we expect to further moderate in '23 (inaudible) quarters. And for this year, we actually see pricing actions exceeding the inflationary cost for those three components.

Scott Schoenhaus: Great. And I guess as my follow-up. How are you thinking about capital allocation from this point forward?

Peter Kuipers: Yes. So I would say from a capital allocation perspective, I think Randall mentioned earlier, the approach for the year as far as planning and the guide, it's fair to say that M&A and strategic acquisition is probably a little bit lower on the on the priorities from that perspective, I want to make sure we've got a large cash balance as we enter the year, of course, as well.

Operator: Our next question comes from the line of Jessica Tassan from Piper Sandler.

Jessica Tassan: And Peter, thanks for all the help over the last couple of years, I'm sure we'll be in touch between now and July, but sorry to see you go. I guess maybe for my first one, is there a difference between recurring or subscription advanced services revenue and what is appearing in short-term backlog for Advanced Services

(technical difficulty)

Randall Lipps: We expect the 10% is revenue for an services. So the way to think about it is really starting with bookings, of course, got into car AR and then you get the revenue, right? So bookings is substantially higher than the 10% we have in the guide for Advanced Services recurring revenue year-over-year increase.

Jessica Tassan: Right. My understanding was that just advanced services revenue was going to grow at something like a 20% to 30% CAGR through 2025. And I'm just interested to know like has that expectation changed? And if so, what is driving that changed expectation? And that's it for me.

Peter Kuipers: Yes. Okay. So that second part of the last part of your question. So we really look at the business from a lens point of care is down from a bookings perspective and a revenue perspective and the delta with the advanced services revenue. There's a lot of delta there because that is growing, right?

So -- and I think it's fair enough to say that the expectations are slightly lower for the time being, also given the current market economic environment, but they are growing nicely. And again, we're somewhat conservative in our approach for planning for the year for '23 as well. So those are things to take into consideration.

Operator: Our next question comes from Bill Sutherland from the Benchmark Company.

Bill Sutherland: Hello, everybody. Peter, I'm not going to say goodbye to you. We'll get around to that. So Scott, I think on a recent conference about improving the forecasting capabilities. I'm curious kind of what etch you've taken?

Kathleen Nemeth: Bill, you kind of broke up there a little bit. Could you repeat that?

Bill Sutherland: Sorry.

Kathleen Nemeth: That's okay.

Bill Sutherland: Mobile phones. I was just curious about what kind of things you've done to just further improve the forecasting and planning functions that you guys, I think, alluded to was something you want to focus on.

Randall Lipps: Sorry, can you repeat it. We couldn't hear it.

Bill Sutherland: I don't want to hold up the call. Am I still fading in and out?

Randall Lipps: Yes. We missed the exact point of improving. Was it cash? Well, we couldn't quite hear.

Bill Sutherland: I was -- okay. You know what, I'll just get on my call back. I'll take care of that.

Operator: Our next question comes from David Larsen from BTIG.

David Larsen: Can you give an update on how far along your base is with regards to the XT upgrades? Are you 60% of the way through, 70% of the way through? And then just broadly speaking, like over what time period does that entire upgrade process happen? Is it like a 10-year process and you're on year 6, which means that over the next 3 years, rest of your base is going to have to upgrade to the XT? And then do people have to upgrade to the XT? Or can they choose not to? And yes, so thanks.

Randall Lipps: Yes. Thank you, David, for the question. So a couple of questions in your 1 question there. So Yes, we're above 60% of the great cycle for XT specifically. However, I think Scott earlier indicated that there are more growth drivers than only a good cycle, but we also have expansion and competitor convergence as well.

After 10 years, we do not provide technical services anymore. It means no more software upgrades and no rate fixed maintenance support you. So for custom work to say compliance they generally upgrade the prior generation equipment.

David Larsen: Okay. So what I think I just heard was about 40% of your base still needs to upgrade to the XT and that was going to have to happen at some point over the next 3 years?

Randall Lipps: Correct. But I think what we said is we're above 60% now. It's a little less than 40%.

David Larsen: Okay. Great. And then for semiconductors, is pricing locked in for all of your semiconductor needs for 2023? And what about 2024? And then like if things heat off in Taiwan, between China and Taiwan, are you protected from that type of an event in terms of your COGS?

Randall Lipps: Yes. I think, David, so we pointed out in the prepared remarks that we have $80 million of previous seats of semiconductors and into, so that gets us a good way into the year to sell customer demands, and we have locked in pricing for the remainder of the year as well. I would say we're not from a risk factor perspective, we're not excluded from any geopolitical impact. And as our risk goes up, we'll continue to manage it as actively as we can.

David Larsen: Okay. And then just in terms of like the hospital clients, I guess, Scott, what are you seeing on the ground? Is there enough labor available in terms of nurses and technicians to actually deploy these cabinets? Or is labor so tight, people just aren't available to deploy these things?

Scott Seidelmann: Thanks, Dave. Look. I mean, hospitals are still struggling with labor challenges. I think labor expenses continue to be higher than they were back in '21, '22, but it seems to be getting better. I think hospitals like any other business or any other organization just takes a bit of time to figure out the new operating reality and that's certainly what it feels like. We are not seeing at this point, sort of major pushback on implementation, timing, et cetera, as a result of those labor constraints. Like we said, I think the environment stabilized. Our processes have stabilized. We know what's working, what's not working, which is the basis of our forecast or guidance in '23.

David Larsen: Okay. And then it's my understanding that there were some very favorable rulings by the Supreme Court and other courts that are positive for like the entire 340B program and hospitals should be getting a pretty significant windfall from those rulings. Any sense for if and/or when that might happen? And I would think that, that could drive some demand for your solutions.

Scott Seidelmann: I think there's a lot of activity in the courts regarding 340B, some good, some bad. I think that it continues to favor our specialty pharmacy service and our 340 BPA business, we're taking a cautious outlook this year on and expect it relatively to be flat year-over-year.

David Larsen: Okay. And then just the last one, and I'll hop back in the queue. In terms of your reported backlog, were there any changes in the way that backlog was estimated? Or was any backlog just kind of written off and reversed out that might reduce like the ending backlog for '22 or your expected backlog for '23. Were there any changes in like the way the calculations were being done?

Randall Lipps: Yes. So thanks Dave, for the question.

The methodology is unchanged for '21 and '22. We haven't forecasted '23 adding backlog, which you can calculate it with the numbers that we provided today.

Operator: Our next question comes from the line of Stephanie Davis from SVB Securities.

Stephanie Davis: I'm sorry to see I'm walking into the party because you're leaving the party. It's like must be going to something much core than I am. Some of -- I was a bit surprised by the quarter and the outlook, reflecting better-than-expected product revenues, while service revenues is a little bit light. Was that more a function of this arm is modeling after last quarter's cuts? Or is there anything to call out there in some of the shifting demand changes versus what you were seeing last rent?

Peter Kuipers: Yes. So particularly for the fourth quarter, with a solid execution by the teams, if you will. Service came in a little bit light, but overall, executed well plus the cost management came in well also for the year.

Stephanie Davis: And the guidance is just kind of the same sort of thing?

Peter Kuipers: Well, for the guide for the first quarter, right? So revenue is expected to be lower quarter-over-quarter to sequentially. So that's the largest impact, if you will. And then, of course, the cost

actions will start kicking in more in the second quarter. But those are the dynamics which you model out the year quarter-by-quarter in.

Stephanie Davis: Understood. And then, Randy, are you still seeing predominantly or within CapEx budgets really contained to the larger health systems, like you mentioned last quarter? Or how have we seen an extension of this a little bit downstream to like a broader set of customer base? I know as were you also mentioned that these budget changes going to be more U-shaped? Is that kind of recovery are playing out so far?

Randall Lipps: Well, I think as Scott said, that I think particularly the Q3, during Q3, a lot of these big health has (inaudible) that the cost dynamics without the Cares Act money that they had to stop their capital spend. And so I think they've now seen that adjustment in May each quarter as we move forward.

They're making adjustments on lower and improve the margins. In fact, I think, last month over the last wave comp and reported some improvement in the margin. So my guess is that will continue to happen and see with the board. But it's going to take -- these are slow-moving tankers. It takes them a little bit of a while, but it feels like once we hit some big macroeconomic another event that they're starting to slowly move forward and create more margin and put more investment into the institutions, which they need, which they know they need to make, particularly in pharmacy.

Operator: Our final question comes from the line of Allen Lutz from the Bank of America.

Allen Lutz: I guess one for Peter and Scott. So if we just look quarter-over-quarter, both revenue segments are down sequentially. But I guess how should we think about the trough quarter? Is 1Q, is it reasonable to think that 1Q is the trough quarter in terms of revenue for both of these segments? Or is it something that's going to be more of a hockey stick ramp over the course of the year? Just trying to understand line of sight into the guide and what you're seeing to give you confidence in the inflection over the course of the year.

Peter Kuipers: Yes. Alex, good question. Yes. Of course, for the fourth quarter through the first quarter is always a little bit of seasonality. So that's -- you got to take that into account. And then we see product revenue modestly increasing through the year, mostly based on already contracted backlog that we had talked about in the prepared remarks and the BSS services revenue and service revenue in totality, is entirely, vast majority of that is really based on the backlog of plan implementation. So that's how we model it out, and you can do it the same.

Operator: I would now like to turn the call over to Randall Lipps for closing remarks.

Randall Lipps: Well, thank you everyone, for joining the call.

Before I conclude the call, I wanted to give a shout out to the global Omnicell team for their hard work and resilience. I mean, throughout 2022 they did not waver on delivering exceptional service to our customers, pursuing our translational journey to an as-a-service business. It is a hard work -- particularly supporting each other and the communities we serve.

So on behalf of myself and the Board of Directors and the leadership team, I thank all of you, dear employees for the great work of 2022.

We look forward to 2023 as we get back to that growth mode and get forward to transforming the pharmacy.

Thanks, everyone.

Operator: Thank you, ladies and gentlemen. This does conclude today's call. Thank you for your participation. You may now disconnect.